

Dear Sirs

I have reviewed your summary of provisional findings and I would like to comment on your provisional findings.

I am a chartered accountant. I trained as an auditor in a small firm, worked as a qualified audit senior in a mid-tier firm, and currently work as a director of finance in a private, medium-sized unlisted group of companies operating in several jurisdictions in North America and Western Europe. I also invest my own cash into funds, own beneficial shareholdings and have even dabbled with spreadbetting.

Overall, I think your findings per paragraphs 31-33 are broadly on target. However, I'm not convinced that a conclusion about the nature of the audit market is valid without also assessing the primary output of the audit market, i.e. an assessment of the value of the financial statements on which a statutory auditor reports.

I believe that the underlying market value of financial statements is very, very low. The audit market therefore looks dysfunctional because it is, in effect, making money by providing a corporate "social service", a requirement that exists solely for legal compliance, but which would not exist in its current form - even if at all - without the legal obligation. The sheer technicality of financial reporting has evolved to turn an opportunistic niche into a self-sustaining industry, yet I'm not convinced it serves its public objectives. How so?

For example, I cannot think of any reasonable, real-world justification to fabricate the value of a share option to re-present it as a cost just because we have some emotional need to have a cost for anything and everything we might use. Yet, technical standards require it, and if the client decides to deviate from this nonsense, the auditor will report something other than "true and fair".

In other words, fabricating costs is supposed to be the fair truth. Well, I suppose a Parliamentarian might see it that way (the expenses scandal bounces to mind immediately), but, personally, I'm inclined to consider it a form of fraud, even if it is legally mandated. Other examples to demonstrate the futility of financial statements include the valuation and amortisation of goodwill, and even the cash flow statement isn't quite what it sounds it should be.

A suitable remedy might be to remove the current obligation for a statutory audit asunder Companies Act 2006 (and current financial reporting standards), and to replace it with a right of shareholders - or any single plurality of them - to form an audit panel and to hire, fire and define the scope of auditors.

This would also remove some of the collateral issues you have identified.

In particular, I have observed/reviewed loan agreements drafted by banks which require the use of a Big 4 auditor. The bank wanted their preferred auditor to do a detailed, non-statutory audit of the client's balance sheet, business model and risks. Yet, ironically, once the loan was to be executed, the bank no longer wanted their preferred auditor. Instead, I found that the bank preferred to use the client's own management systems to monitor borrowing covenants, without audit. So much for wanting assurance. Moreover, given that all auditors are congruently regulated, why prefer a brand of auditors, rather than the best-value auditor available to do the job? A brand of auditor doesn't demonstrate competence, expertise or even track-record. To my mind, the bank's contractual demand for its irrelevant preference amounts to economic vandalism to the client. Remember, the client pays the fees of the bank's preferred auditor (without meaningful negotiation, in my experience), yet gets nothing for it, except a higher debt with more interest to pay, and less cash to fund what should have been business investment: what an amazing co-incidence!

My comments are my own views only, and form no representations with any other party.

Yours faithfully

Martin J Thornhill (1 April 2013)